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No. 80-708

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ROCCO CATENA, *Petitioner,*

v.

CAPITOL INDUSTRIES, INC., ET AL., *Respondent.*

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Was the District Court's finding, unanimously affirmed by the Court of Appeals, that Respondents' alleged acts and omissions, if any, did not result from the requisite culpability required under Rule 10b-5 clearly erroneous?

2. Did the refusal of the District Court, affirmed by a unanimous Court of Appeals, to admit into evidence an "accountant's extraordinary memorandum" constitute reversible error?

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PRELIMINARY STATEMENT

The fundamental flaw in the position of Petitioner ("Catena") is his mischaracterization of the two decisions of the courts below.[1] Once this mischaracterization

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[1] It should be noted that subsequent to affirming the District Court, the Court of Appeals denied Catena's Petition For Rehearing En Banc.

becomes clear to this Court, it will be seen that the only real questions which Catena raises turn on the particular facts of this case and are of interest only to the parties to it.

In essence, Catena asks this Court to make a third review of the lengthy trial record to determine whether it can find what two previous courts have been unable to find — *i.e.*, proof of some culpability on the part of Respondents[2] sufficient to render them liable under Rule 10b-5. This Court has ruled in the past that such a factual analysis is not a task to be served by a grant of certiorari. *United States* v. *Johnson*, 268 U.S. 220, 227 (1925).

At pages 4-28 of his Petition, Catena sets forth his contentions concerning the merits of the case. In substance, these contentions are identical to the ones he pressed in both the trial and appellate courts below and which were rejected by both such courts. These contentions, which focus solely on the evidence which Catena believes is most favorable to his position, are rife with factual inaccuracies and exaggerations; such contentions do not even purport to deal with the evidence presented by Respondents and which the District Court found persuasive. Respondents will not burden this Court with a refutation of these factual contentions.[3] In light of the fact that four judges have already rejected them,

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[2] Petitioner correctly lists the names of Respondents in footnote 1 of his Petition with the exception that "William P. Rozette" should read "Walter P. Rozett".

[3] One example, however, should suffice to illustrate the point. At pages 10-13 of his Petition, Catena argues that Respondents knowingly employed an erroneous method of accounting for sales returns and that this method resulted in a substantial overstatement of Capitol's reported earnings. Catena fails to mention, however, that Respondents' expert witness at the trial and two independent

Respondents are confident that this Court, in determining whether the writ should issue, will take them with the pound of salt they deserve.

STATEMENT OF THE CASE

After voluminous discovery which continued almost without interruption for over three and one-half years, the trial in this matter commenced on September 30, 1975, and consumed approximately 58 days. In the course of the trial, testimony was received from 30 lay and expert witnesses — testimony reflected in approximately 8,000 pages of record. In addition, approximately 800 exhibits were received into evidence and considered by the District Court. At the conclusion of the trial, the parties submitted detailed post-trial briefs largely devoted to an intensive analysis of the facts presented by the testimonial and documentary evidence. A large portion of this evidence was directed to the extremely complicated bookkeeping, accounting, sales, inventory, and other policies, practices, and problems endemic to the industry of which Respondents were a part.

In rendering its opinion, the District Court first addressed itself to the primary contention which Catena had made over and over again from the inception of the case:

> "The plaintiff's case is based primarily upon the contention that the defendants engaged 'in a com-

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auditing firms prior to the commencement of this litigation opined that the accounting method employed by Capitol for sales returns was perfectly appropriate. (Exhibit 21B at 12 and 18; Exhibit OR-20 at 4; Exhibit 448 at 1; R.T. 5014-5017 and 7833) Nor does Catena mention that, contrary to his contention, Respondents presented evidence at the trial that the use of the accounting method espoused by him, as opposed to the one employed by Capitol, would not have resulted in any dramatic difference in Capitol's reported earnings. (C.T. 3003-3022; Exhibit SCH-4; Exhibit OR-20 at 4-5; R.T. 2779-2783, 3623, and 6723-6731)

> mon course of fraudulent conduct designed for one central purpose, i.e., to misrepresent the operating results of [Capitol Industries, Inc.] so as to artificially inflate the market price of Capitol common stock.'" (Appendix to Petition at 7)

The District Court then stated its conclusion with respect to Catena's primary contention:

> "The basic trouble that I have with the plaintiff's case is that I am unable to conclude from the evidence that any such fraudulent purpose has been established." (*Id.*)

The District Court did not stop there, however. Not only did it find that there was no "fraudulent purpose" or, in other words, intentional misconduct involved, but it also found that Respondents' conduct could not be characterized as reckless in nature. On the contrary, such conduct could only be characterized, *at most*, as "unwise or imprudent or even inept". The District Court further found that Respondents had made "appropriate bookkeeping records of their transactions, and . . . such disclosures in their releases to stockholders and the public as were indicated under the circumstances." (*Id.*, at 11)

Catena, therefore, completely mischaracterizes the opinion of the District Court when he attempts to persuade this Court, in the same manner that he unsuccessfully tried to persuade the Court of Appeals, that the District Court had found only that there was no "fraudulent purpose" involved and that reckless conduct was not a sufficient predicate upon which to base liability under Rule 10b-5.

In the same manner, Catena now also mischaracterizes the decision of the Court of Appeals. According to that court,

> "The district court found that the conduct of appellees was based on good faith judgments, which, as a matter of hindsight, may have amounted to, at most, negligence." (*Id.* at 2)

The Court of Appeals then turned its attention to Catena's attack on this finding:

> "Catena challenges as clearly erroneous the court's finding that there was no more than negligence." (*Id.* at 2-3)

The Court of Appeals concluded that, contrary to Catena's assertion, the District Court's conclusion on this score was not clearly erroneous. Thus, the statement in the Petition that "the Ninth Circuit's affirmance must be taken to mean that there can be no liability under Rule 10b-5 unless it is first shown that a defendant possesses a sinister motive or a fraudulent purpose" is a total mischaracterization.

Once this Court preceives Catena's mischaracterization of the opinions below, it must conclude, we respectfully submit, that what Catena is really attempting to do here is to persuade this Court to review again the conclusions the District Court drew from the voluminous testimonial and documentary evidence at the trial and to draw conclusions from that evidence favorable to Catena. This task is obviously an inappropriate one for this Court to undertake.

REASONS WHY THE PETITION SHOULD BE DENIED

1. The Questions Of Law Under Rule 10b-5 Which Catena Purportedly Seeks To Raise Before This Court Are Illusory.

The two questions of law under Rule 10b-5 which Catena purportedly seeks to raise before this Court have been framed by him in the first two paragraphs of his Questions Presented:

> "1. Where a public reporting company recklessly misrepresents or omits to state material facts to the investing public, does liability arise under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and if so, do defendants' professions of 'good faith' constitute a defense to such reckless reporting practices?
>
> "2. Where a public reporting company knowingly or recklessly misrepresents or omits to state material facts to the investing public, does proof that the officers and directors of that company acted in 'good faith' in managing the company's affairs insulate the company and its officers and directors from Rule 10b-5 liability to purchasers of the company's common stock?"

These two questions of law are illusory. In the first place, each question assumes a fact which the courts below found to be false — namely, that Respondents were guilty of reckless misrepresentations or omissions. In the second place, Respondents have never contended, and neither of the courts below held, that professions of "good faith" constitute a defense to "reckless reporting practices." In like manner, Respondents have never contended, and neither of the courts below held, that "good faith" in managing a company's affairs insulates the company and its officers and directors from Rule 10b-5

liability even though the company knowingly or recklessly misrepresents or omits to state material facts to the investing public.

What the courts below did hold was that Respondents' conduct, both in managing Capitol's affairs *and* in reporting such affairs to the investing public, were *at most* negligent and that, therefore, under *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), Respondents could not be held liable under Rule 10b-5. Therefore, in claiming that the courts below rejected "recklessness" as a degree of culpability requisite for liability under Rule 10b-5, Catena has mischaracterized the opinions of both courts. In fact, Catena impliedly admits this mischaracterization in another portion of his Petition when he states:

> "A critical issue in this case was whether Capitol's alleged misconduct constituted actionable recklessness within the meaning of Rule 10b-5. With little elaboration, the District Court found that it did not." (Footnote and citation omitted) (Petition at 55)

This being the case, the decision of the Court of Appeals with respect to which review is being sought here does not, contrary to Catena's assertion, create a conflict among the Circuits because the two substantive issues which Catena claims are the basis of the alleged conflict are illusory.

2. This Case Is An Inappropriate One In Which To Decide Whether Mixed Questions Of Fact And Law Of The Kind Involved Here Are Subject To The "Clearly Erroneous" Standard Of Federal Rule Of Civil Procedure 52(a) Because Catena Did Not Raise This Issue In A Timely Manner In The Court Of Appeals And, Indeed, Argued To The Contrary. Moreover, The Issue Is Not Sufficiently Important To Warrant This Court's Attention.

At pages 54-60 of his Petition, Catena argues that the Court of Appeals erred in applying the "clearly erroneous" standard of review under Federal Rule of Civil Procedure 52(a) to the District Court's finding that Respondents' alleged misconduct did not constitute actionable recklessness within the meaning of Rule 10b-5. Not only did Catena fail to raise this "standard of review" issue in the Court of Appeals in a timely manner,[4] but, as indicated by the following sentence from ~~the~~ its opinion, he tacitly acknowledged the correctness of the standard of review which he now attempts to criticize: "Catena challenges *as clearly erroneous* the court's finding that there was no more than negligence." (Emphasis added) (Appendix to Petition at 2-3) Under these circumstances, this Court should apply its normal rule that it will not consider questions which are not raised by the petitioner below. See *United States* v. *Ortiz*, 422 U.S. 891, 898 (1975)

Even were Catena not precluded from raising the issue, the fact still remains that the issue concerning the

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[4] After arguing before the three judge panel of the Court of Appeals that the District Court's finding was "clearly erroneous", Catena first challenged the correctness of this standard of review in his Petition For Rehearing En Banc.

appropriate standard of review which he seeks to raise here is not sufficiently important to warrant this Court's attention. It is not surprising that Courts of Appeals have struggled from time to time with the issue of the standard of review accorded to mixed questions of fact and law. This case, however, hardly presents the opportunity to clarify that issue.

The finding of the District Court which Catena contends was subjected to an erroneous standard of review by the Court of Appeals is the finding that no "actionable recklessness" was involved in this case. As Catena notes, "[r]ecklessness has traditionally been defined as highly unreasonable conduct accompanied by a conscious indifference to the consequences." (Petition at 38) It may be that the two elements of this definition — "highly unreasonable conduct" and "conscious indifference" — are properly subject to two different standards of review, since the latter element involves state of mind while the former does not. At any rate, no matter how this issue should be resolved, an opinion by this Court on this issue of appellate procedure would hardly provide a blueprint by which Courts of Appeals could determine what standard of review should be applied to the often multi-faceted and complex mixed questions of fact and law which come before them.

Accordingly, even if Catena had not waived this point in the Court of Appeals, the issue is not of sufficient importance to warrant this Court's attention.

3. The Issue Sought To Be Raised With Respect To The District Court's Evidentiary Ruling On The "Accountant's Extraordinary Memorandum" Lacks Any Precedential Significance.

The final issue which Catena seeks to raise here is whether the District Court erred in excluding a document characterized by the Court of Appeals as an "accountant's extraordinary memorandum" on the grounds that it did not fall within the so-called "business records" exception to the hearsay rule codified in Federal Rule of Evidence 803(6).

The document in question is a "Private Memorandum" prepared by a partner at Coopers & Lybrand eight months after the end of the class period involved in this litigation. As it indicates on its face (Appendix to Petition at 18-28), its genesis was a personality conflict between its author and the then Vice President Finance of Capitol, whom the author of the memorandum viewed as someone who identified with Capitol's minority shareholders and was "hostile" to Coopers & Lybrand from the beginning, possibly because Coopers & Lybrand had been appointed "via EMI", Capitol's majority shareholder.

Based on these considerations, the District Court stated:

> "It is one thing to call for the work papers. It is one thing to call for the formal report. Those things are prepared with some care, with the thought that they would be part of the record, and a tangible memorandum of the work of the company.
>
> "It is another thing for one partner to make a memorandum, perhaps off the top of his head, perhaps in white heat, perhaps with a shortcut of communication, that he does not view as con-

stituting a permanent part of the record." (R.J. 4970)

Contrary to Catena's assertion here, neither the District Court in its ruling, nor the Court of Appeals in its affirmance, relied on any notion that, to be admissible under Federal Rule of Evidence 803(6), a business record has to be of a repetitive or routine nature. Rather, their rulings were based on the unusual nature of the "accountant's extraordinary memorandum" in question and the circumstances surrounding its preparation, both of which strongly indicated that the document had not been prepared with the safeguards which Congress had in mind in promulgating the Federal Rules of Evidence. Thus, viewed in proper context, the resolution of this evidentiary issue would only be of potential significance to the parties to this litigation; it would not provide any precedential significance with respect to the scope and meaning of Federal Rule of Evidence 803(6).

Moreover, whether such a ruling would even be of significance to the parties to this litigation would depend on this Court's resolution of yet another issue which it would have to face if it concluded that the District Court had erred in excluding the document. That issue would be whether the District Court's erroneous evidentiary ruling constituted reversible error because it affected a "substantial right" of Catena within the meaning of Federal Rule of Evidence 103(a). This latter issue would be difficult to resolve in Catena's favor in light of the District Court's statement at the time of its ruling that, if the "accountant's extraordinary memorandum" were to be admitted into evidence, "the effect on the Court's judgment would be miniscule. . . ." Since in light of that statement this Court would probably feel compelled to hold that there was no reversible error, its discussion of

the correctness of the evidentiary ruling in question would be an academic exercise of no precedential significance.

CONCLUSION

As demonstrated above, the issues which Catena has tendered to this Court are either nonexistent or unworthy of this Court's attention. Respondents submit, as a result, that the Petition should be denied.

Respectfully submitted,

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